IN THE

# Supreme Court of the United States

OCTOBER TERM 1961

No. 504

SCRIPTURE PRESS FOUNDATION, *Petitioner*,

v.

UNITED STATES OF AMERICA, *Respondent*

**On Petition for a Writ of Certiorari to the United States Court of Claims**

## PETITIONER'S REPLY BRIEF

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Petitioner files this Reply Brief to call the Court's attention to the increased confusion surrounding the issue presented by this case and the even greater need for an authoritative resolution of that issue.

1. The United States has conceded (Brief, pp. 12-13) that the Court of Claims has rendered "contrary"

decisions in the two *Sico* cases[1] and that the court, in the second *Sico* case and in the instant case, has interpreted the 1950 amendments "as reflecting a Congressional rejection of the ultimate destination of the funds as the sole criterion of exemption after 1950." The Government has thereby put into sharp focus the confusion that abounds as to whether the ruling of this Court in *Trinidad* v. *Sagrada Orden*, 263 U.S. 581 (1924)—that "the destination [is] the ultimate test of exemption"—is still controlling.

That confusion has been further compounded since the filing of the petition and of the Government's brief in opposition. On January 12, 1962, a majority of the Judges of the Court of Claims overruled a motion for rehearing in the second *Sico* case. But two Judges filed a dissenting opinion, written by the author (Chief Judge Jones) of the opinion below in the instant case. That opinion is reprinted in the appendix hereto. In this dissenting opinion, Chief Judge Jones takes direct issue with the position espoused by the Court of Claims in the second *Sico* case and in the instant one that destination is no longer decisive in determining the right to exemption. In his words:

> "The majority opinion states that the 'destination of the corporation's income is no longer decisive in determining its right to exemption.' *We regard the destination as all-important.* For any

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[1] In the first *Sico* case, *Sico Company* v. *United States*, 121 Ct. Cls. 373, 389, 102 F. Supp. 197, 199 (1952), the court stated that "the exemption from taxation granted by the statutes makes the destination of the income . . . rather than its source, the ultimate test of its exemption." But in *Sico Foundation* v. *United States*, 61-2 C.C.H. ¶9732 (Ct. Cls., Nov. 1, 1961), the court said that "the destination of a corporation's income is no longer decisive in determining its right to exemption."

> income to be tax exempt it must be devoted exclusively to religious, educational, or charitable purposes. The [1950] amendment did not in any sense change this requirement. It simply added the additional requirement that the funds of the organization for which exemption is claimed *must not arise from business operations that would thus by virtue of its tax exemption have an advantage over competing commercial companies.*" [emphasis supplied]

Obviously, Chief Judge Jones has changed his own mind since writing his opinion in the instant case and has repudiated his former position and now advocates the position of the Petitioner that the destination test has not been destroyed, but has been merely qualified so as to make it inapplicable to activities which are competitive with regular commercial taxpaying organizations.

The appropriateness and, indeed, the necessity of review by this Court thus become increasingly apparent. The completely divergent viewpoints as to whether the destination or the source is the hallmark of exemption, in situations where commercial competition is absent, have created confusion and chaos in the administration of § 501(*c*)(3) of the Internal Revenue Code of 1954.

2. The United States, having finally decided to support the decision of the Court of Claims in this case,[2] seeks to shift the emphasis from the uncontroverted

[2] The United States was uncertain as to what position to take with respect to the question raised in the petition. In seeking and obtaining an extension of time in which to respond to the petition, the United States advised this Court that "differences of view have arisen among government counsel as to the position the government should take in this case", making an extension necessary "to permit consultation among the interested agencies in order to resolve these differences."

evidence that all of petitioner's profits are devoted exclusively to religious or educational purposes. The claim now is that the disparity between petitioner's sales and religious or educational expenditures was so great and resulted in such steadily increasing accumulated earned surplus that petitioner's primary activity must *a fortiori* be considered to be that of carrying on a business for profit. Brief, pp. 8-9.[3]

The vice of the Government's position is that the accumulation of earned surplus by any exempt organization serves to weaken and then destroy its exemption. That is precisely why the ruling below throws into jeopardy the tax exemption of every religious, educational and charitable organization in the country that dares to accumulate some of its profits even though dedicated and eventually used for exempt purposes, such as in the case of the denominational publishing houses and the National Geographic Society. And that jeopardy is created in the context of a situation where

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[3] The Government, as did the court below, refers (Brief, p. 5) to *annual* expenditures for religious educational purposes, in comparison to *accumulated* capital and surplus. Such a computation, however, fails to consider cash donations and merchandise grants, as well as petitioner's building, as being part of petitioner's expenditures in furtherance of its admitted purpose to "improve and better Sunday Schools" and in furtherance of its admitted contribution of the growth of Sunday Schools in the United States (Finding 54, Pet. 60a).

Although the court below found only a total of $296,483.34 for expenditures in 1951-1957 for religious educational purposes, the true total figure revealed by the record (including donations and grants) was $432,842.01. This was the result of an oversight by the Commissioner in overlooking two uncontrovered exhibits of petitioner. Adding the cost of the building brings the total religious expenditures to $1,675,864.89, with only $591,086.89 of accumulated surplus remaining unexpended. Even the latter amount is irrevocably dedicated to the petitioner's exempt purposes.

the uncontroverted finding has been made (Finding No. 55, Pet. 61a) that petitioner's selling activities in no way compete with commercial business, its sole competition in this field being with exempt religious publishing organizations.

The emphasis thus placed on accumulated earned surplus—to the total exclusion of the fact that such surplus is eventually spent solely for religious or educational purposes—serves to pervert and destroy the destination test. As was said in *Trinidad* v. *Sagrada Orden*, 263, U.S. 578, 581 (1924), a corporation may be "organized and operated exclusively for religious, charitable, scientific or educational purposes, and yet have a net income." And tax exemption would not seem to turn on whether that net income is immediately spent or is accumulated, so long as it is devoted exclusively to religious educational purposes.

Most schools, hospitals and social clubs are organized under not-for-profit corporate laws. However, there are also many schools, hospitals and social clubs which by choice have been organized on the same basis as any regular business concern with its net profits being distributed to the stockholder owners. Although these organizations might have identical facilities, programs, charges, income and profits, the former are tax exempt while the latter are not. Certainly the "source" test does not determine tax status for these organizations, as the source of revenue in both types of organizations is identical. Why then is one exempt and the other not? This is simply because the net income or profits and accumulated earned surplus is "destined", dedicated, or used for two different purposes. In the one instance the net income or profits and accumulated earned surplus is "destined", dedi-

cated and used to further the exempt purposes, while in the other instance to line the pockets of the stockholder owners. Although there are a number of schools, hospitals and social clubs organized as commercial profit concerns, nevertheless this is still not a field of business or activity which is considered commercially competitive, and there is therefore no prohibition to having tax exempt schools, hospitals and social clubs. Those schools, hospitals and social clubs which are organized for profit do so by choice and are therefore taxable by choice. In the field of publishing Sunday School lesson material, which is the activity of the petitioner, this is also a field where commercial competition is absent. However, in certain religious, educational and scientific publishing fields, where there is commercial competition, the latter are commercial and non tax exempt by choice and not mandatorily so, as would be the case in an ordinary business or commercial activity. There are no commercial taxpaying concerns who suffer a disadvantage at the hands of petitioner or others engaged in similar activity. The destination of the net income or profits and accumulated earned surplus in such type organizations must therefore continue to be the sole test of tax exemption.

3. The Government's claim (Brief, pp. 14-15) that review of this case might not result in clarification of the destination test is without merit. It is not necessary for this Court to resolve any question of Illinois law in order to reach the federal tax exemption question. The short reason is that no decision or *obiter dictum* of the Illinois Supreme Court in the *Annunzio* or any other case can be decisive in determining eligibility for federal tax exemption. And, as the Government concedes (Brief, p. 15), the Court of Claims did not rest its decision on any local law ground.

The longer answer, and one that need not be pursued here at length, is that every indicia (including the original charter) of the purposes to which the petitioner was organized, operated and devoted, including expenditure of its funds, in 1953 were of a religious or educational nature. There is not one scintilla of evidence, let alone findings, that petitioner in any sense nurtured any other type of purpose.

The fact situation in the instant case thus sharply presents the question, in situations where commercial competition is absent, whether the destination test, which test originated with this Court, is still the sole criterion of tax exemption, or whether exemption is lost merely because activities produce a net income or profit and there is an accumulation of earned surplus. That is the question that disturbs the tax bar, that has confused the courts below and that has cast into doubt innumerable tax exemptions now extant.

For these various reasons, the petition for certiorari should be granted.

Respectfully submitted,

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